Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of the Local Competition Provisions in the Telecommunications Act of 1996	)	CC Docket No. 96-98
	)	
Intercarrier Compensation for ISP-Bound Traffic	)	CC Docket No. 99-68

FURTHER SUPPLEMENTAL WHITE PAPER ON ISP RECIPROCAL COMPENSATION

The purpose of this supplemental submission is to address several recent ex parte letters filed in this proceeding.

First, any holding that ISP-bound traffic is "both" section 251(b)(5) traffic and section 201 traffic is contrary to the statute and would not survive appellate review. The Commission has unquestioned authority to regulate jurisdictionally interstate traffic under section 201; ISP-bound traffic is jurisdictionally interstate. To read section 251(b)(5) as applying to such interstate traffic would significantly *limit* the Commission's regulatory authority, because section 252 includes procedural and substantive standards to govern section 251(b)(5) traffic — standards that give private parties authority to negotiate terms and that place authority for implementation with state commissions. Subjecting section 201 traffic to reciprocal compensation under section 251(b)(5) would thus violate section 251(i), which provides that section 251 shall not be construed to impose such limitations. Moreover, aside from being legally untenable, such a determination — far from preserving the Commission's options —

would restrict the Commission's regulatory authority over interstate traffic and dim the prospects for meaningful intercarrier compensation reform.

Second, applying section 251(b)(5) only to traffic that originates and terminates in the same local calling area — in accordance with the Commission's original rule — does not lead to absurd results. To the contrary, that rule has not led to any significant implementation problems *other than* those associated with the *mischaracterization* of ISP-bound traffic generally (and ISP-bound Virtual NXX traffic in particular) under that rule. Furthermore, adopting the CLECs' proposal would mean that the Commission could not move beyond modifications of existing access charge obligations to more fundamental reforms without subjecting interstate traffic to the substantive standards of section 252(d)(2) and ultimate state authority.

Third, elimination of rate caps, growth caps, and new market restrictions would promote the very regulatory arbitrage the Commission had sought to eliminate. Despite growth in broadband deployment, dial-up minutes have not declined substantially: indeed, traffic from ILECs to CLECs still exceeds traffic in the other direction by a ratio of 17:1 — proof that CLECs continue to exploit the ISP/reciprocal compensation windfall. To *expand* that arbitrage opportunity would encourage CLECs and ISPs to promote dial-up traffic at the expense of broadband — thereby undermining fundamental Commission policies.

Fourth, the Commission should reject the requests of various carriers, including Level 3 and ALTS, that the Commission modify the existing intercarrier compensation rules for calls to ISPs located in a *different* local calling area from the calling party.[1] Although calls to ISPs are, as the Commission has held, jurisdictionally interstate, the Commission has permitted ISPs to purchase service from local business tariffs, pursuant to the ESP exemption. The ESP exemption

[1] *See* Letter from John T. Nakahata, Harris, Wiltshire & Grannis, LLP, to Marlene H. Dortch, FCC (Sept. 10, 2004) ("Level 3 Sept. 10 Letter").

simply enables *ISPs* to avoid paying access charges; it does not alter the traditional distinction between inter- and intra-exchange traffic and does not subject inter-exchange calls to reciprocal compensation.

I. Any Ruling That Section 201 Traffic Is Subject to Reciprocal Compensation Under Section 251(b)(5) Would Be Legally Untenable and Would Restrict Commission Authority over Compensation Issues

There is no merit to Level 3's claim that the Commission could lawfully conclude that ISP-bound traffic "falls within both Section 201 and Section 251(b)(5)." Level 3 Sept. 13 Letter[2] at 1; *see also* ALTS Sept. 22 Letter[3] at 2-3. First, the argument that ISP-bound traffic is simultaneously section 251(b)(5) traffic and section 201 traffic is legally untenable and could not survive appellate review. Indeed, it was largely the Commission's previous effort to fudge the dividing line between states' authority to regulate reciprocal compensation for local traffic under section 251(b)(5) and the Commission's authority over intercarrier compensation for interstate traffic under section 201 that confused the D.C. Circuit and led to the vacatur of the Commission's 1999 *ISP Declaratory Ruling*. Second, the effect of adopting Level 3's proposal would be to *constrict* the Commission's authority over interstate and Internet traffic, and over the intercarrier compensation for such traffic in particular.

The Commission has found, in a variety of contexts, that traffic bound for ISPs for delivery to the Internet is *interstate* traffic for jurisdictional purposes.[4] The D.C. Circuit has

[2] *See* Letter from John T. Nakahata, Harris, Wiltshire & Grannis, LLP, to Marlene H. Dortch, FCC (Sept. 13, 2004) ("Level 3 Sept. 13 Letter").

[3] *See* Letter from Jason Oxman, ALTS, to Marlene H. Dortch, FCC (Sept. 22, 2004) ("ALTS Sept. 22 Letter").

[4] *See, e.g.*, Order on Remand and Report Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Intercarrier Compensation for ISP-Bound Traffic*, 16 FCC Rcd 9151, ¶ 55 (2001) ("*ISP Remand Order*") ("ESPs use *interstate* access service"; "the link LECs provide to connect subscribers with ESPs is an interstate access service"), *remanded, WorldCom, Inc. v. FCC,* 288 F.3d 429 (D.C. Cir. 2002), *cert. denied,* 538

agreed with that determination, *see Bell Atlantic Tel. Cos. v. FCC*, 206 F.3d 1, 5 (D.C. Cir. 2000), and no party challenges it here. Section 201 vests the Commission with jurisdiction over ISP-bound traffic — including the intercarrier compensation, if any, due for such traffic — no different from any other interstate traffic. Indeed, because ISP-bound traffic is jurisdictionally interstate, even if the 1996 Act had never been passed, and local competition had developed subject to state regulations, the Commission would still have authority to regulate the terms of intercarrier compensation for ISP-bound traffic under section 201.

In the 1996 Act, Congress made clear that the new local competition provisions in section 251 were not to be interpreted to apply to matters that were already within the Commission's traditional area of authority. Thus, section 251(i) provides that "[n]othing in this section [251] shall be construed to limit or otherwise affect the Commission's authority under section 201." 47 U.S.C. § 251(i). Construing section 251(b)(5) to apply to ISP-bound traffic, as Level 3 and other CLECs would have the Commission do, would conflict with this clearly expressed congressional intent. Any traffic that is subject to section 251(b)(5) is also subject to the procedural requirements of section 252 and, moreover, to the substantive pricing rule in section 252(d)(2). Because section 252 governs the procedural and substantive standards governing

---

U.S. 1012 (2003); Memorandum Opinion and Order, *GTE Tel. Operating Cos.*, 13 FCC Rcd 22466, ¶ 19 (1998) (ISP-bound calls "do not terminate at the ISP[] . . . but continue to the ultimate destination or destinations, very often at a distant Internet website accessed by the end user"); First Report and Order, *Access Charge Reform*, 12 FCC Rcd 15982, ¶ 341 (1997) (ESPs "may use incumbent LEC facilities to originate and terminate interstate calls"); Order, *Amendments of Part 69 of the Commission's Rules Relating to Enhanced Service Providers*, 3 FCC Rcd 2631, ¶ 2 (1988) (ESPs are "providers of interstate service[]" and "exchange access users"); Notice of Proposed Rulemaking, *Amendments of Part 69 of the Commission's Rules Relating to Enhanced Service Providers*, 2 FCC Rcd 4305, ¶ 7 (1987) (ESPs, "like facilities-based interexchange carriers and resellers, use the local network to provide interstate services"); Memorandum Opinion and Order, *MTS and WATS Market Structure*, 97 F.C.C.2d 682, ¶ 83 (1983) ("*MTS/WATS Market Structure*") (ESPs "employ exchange service for jurisdictionally interstate communications").

rates for 251(b)(5) traffic, a finding that interstate traffic is subject to reciprocal compensation under section 251(b)(5) — far from granting the Commission new authority over local competition — would substantially restrict the Commission's pre-existing authority to regulate intercarrier compensation under section 201.

Specifically, section 252 (as well as section 251(c)(1)) provides that parties must implement section 251(b)(5) through the negotiation and arbitration of binding interconnection agreements. *See* 47 U.S.C. § 252(a)(1); *id.* § 251(c)(1). Carriers, therefore, would have the authority to negotiate agreements that conflict with any rules the Commission might adopt under sections 251(b)(5) and 252(d)(2). *See id.* § 252(a)(1). And, in the absence of voluntary agreements, arbitration of disputes would be the responsibility of state public service commissions, not the Commission. For that reason, the implementation of any rules that the Commission may establish to govern intercarrier compensation for 251(b)(5) traffic will be the responsibility of state commissions, not the Commission.[5]

Just as important, the 1996 Act severely constrains the Commission's authority to establish rates for section 251(b)(5) traffic. Section 252(d)(2) establishes a specific standard to govern "the terms and conditions for reciprocal compensation" that a "state commission" may consider "just and reasonable." 47 U.S.C. § 252(d)(2). It is that section 252(d)(2) standard — and not the just and reasonable standard of section 201 — that would govern intercarrier compensation for ISP-bound traffic. Indeed, even Level 3 ultimately concedes that the Commission would have no authority to make any "pricing determinations" under section 201

[5] Contrary to Level 3's claim, the Commission could not order carriers to implement such rules "through other Title II mechanisms, such as tariffs," Level 3 Sept. 13 Letter at 2, without running afoul of the requirements of section 252. *See, e.g., Wisconsin Bell, Inc. v. Bie,* 340 F.3d 441, 444 (7th Cir. 2003) (finding that a "tariffing requirement" "interfere[s] with the procedures established by the federal act" for the creation of interconnection agreements).

that did not comply with section 252(d)(2). Level 3 Sept. 13 Letter at 2. Nor could the Commission, as Level 3 claims, establish "prices" for section 251(b)(5) traffic under section 201. To the contrary, the Supreme Court has squarely held that state commissions, and not the Commission, must establish the rates to be charged under section 252. *See AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 384 (1999) ("It is the States that will . . . determin[e] the concrete result in particular circumstances."). The Commission's role is limited to establishing the pricing "methodology." *Id.* It would, therefore, be state commission decisions, not this Commission's decisions, that establish the ultimate rates that must be paid for ISP-bound traffic, if it were subject to section 251(b)(5).

For these reasons, finding that ISP-bound traffic is subject to section 251(b)(5) would limit the Commission's authority to regulate this interstate traffic, including the intercarrier compensation for such traffic, regardless of whether the Commission contends that this traffic is also subject to section 201. This alone would frustrate the Commission's ability to develop a uniform policy for Internet protocol traffic in particular, and likely would frustrate the Commission's ability to achieve its goal of comprehensive intercarrier compensation reform. There is no clear distinction between the ISP-bound traffic at issue here and other forms of traffic that do not terminate locally, including calling card traffic, Feature Group A traffic, IP gateway traffic, and even switched access generally. Thus, a finding that ISP-bound traffic is subject to section 251(b)(5) could quickly be extended to apply to these other forms of interstate traffic, with the result that the Commission will have ceded its jurisdiction over all of this traffic. Indeed, the same CLECs that urge the Commission to find that ISP-bound traffic is subject to section 251(b)(5) contend that this section is properly interpreted to apply to all traffic exchanged between all carriers.

It is no answer to suggest that the Commission could retain authority over ISP-bound traffic by establishing a pricing methodology that requires bill and keep. As explained above, any such methodology would be implemented through private agreements and by state commissions, limiting the authority that the FCC normally exercises over traffic that is subject to section 201. In any event, the Commission's authority to adopt a "methodology" that would mandate the use of bill and keep for ISP-bound traffic (or any other traffic) under section 251(b)(5) is, at best, unsettled. Therefore, there remains significant litigation risk with respect to the Commission's authority to impose that result under those statutory provisions. And, if the Commission were to proceed under section 251(b)(5) and is subsequently found to lack the authority to adopt a methodology that mandates a particular pricing result — such as bill and keep — then the Commission clearly will have ceded to the states the bulk of its authority over ISP-bound traffic under section 201, in direct contravention of section 251(i).

Moreover, as a matter of statutory construction, it would be no answer to the conflict with section 251(i) to say that there may be one narrow scenario under which the Commission might be able to exercise authority even if ISP-bound traffic is treated as subject to section 251(b)(5) — namely, if the Commission were to mandate bill-and-keep arrangements for all ISP-bound traffic. As explained above, it is uncertain at best that the Commission could do so under section 251(b)(5). Even aside from that fact, there is no question that treating ISP-bound traffic as subject to 251(b)(5) would foreclose any number of other potential outcomes, such as specifying a particular rate for this traffic because that task is assigned by section 252 to the states. And the statute must be read in a way that harmonizes its provisions under all potential scenarios, and not just one. Because the decision to regulate ISP-bound traffic under section 251(b)(5) would eliminate the Commission's authority to adopt *any other rule* permitted under section 201, therefore, it unquestionably would contravene section 251(i).

In contrast, reaffirming that ISP-bound traffic is not subject to section 251(b)(5) will not limit the Commission's ability to implement comprehensive reform of intercarrier compensation. As we have explained at length in previous submissions, sections 251(b)(5) and 252(d)(2) are limited only to traffic that originates on the network facilities of one local exchange carrier and terminates on the network facilities of an interconnecting local exchange carrier within the same local calling area. *See* White Paper at 26-31 (filed May 14, 2004); Supp. White Paper at 16-17 (filed July 20, 2004).[6]

- *First*, the reciprocal compensation obligation imposed by section 251(b)(5) applies only to interconnecting local exchange carriers ("[e]ach *local* exchange carrier"); it would be unworkable to read that provision as applying to traffic that LECs exchange with IXCs, because IXCs have no obligation under that provision to agree to pay LECs for the termination of traffic.

- *Second*, the express terms of the 1996 Act make clear that reciprocal compensation applies only to traffic that *terminates* on the network of an interconnecting local exchange carrier and that, again, excludes long-distance traffic, which does not terminate on the network of an interconnecting LEC (and, as noted above, in many instances will not be exchanged with another LEC at all, but instead will be exchanged with an IXC).

- *Third*, the historical background and the legislative history reinforce the conclusion that section 251(b)(5) is limited to local telecommunications: reciprocal

[6] AT&T *et al.* note the Commission's determination that, under CALEA, "there can be multiple terminations within a single call." Order on Remand, *Communications Assistance for Law Enforcement Act*, 17 FCC Rcd 6896, ¶ 44 (2002); *see id.* ¶ 45 n.89. Under CALEA, "termination" is one of four types of "call-identifying information." 47 U.S.C. § 1001(2). Because the Commission found that "there are multiple points in a call at which there is information that identifies the called party," there can be "multiple terminations" — that is, multiple pieces of information within a single telephone call that identifies the called party. *Id.* ¶ 44. The Commission did not, however, conclude that, for purposes of determining its jurisdiction or carriers' compensation obligations, the call actually "terminates" at all of the points where call-identifying information is available. Thus, the Commission's decision in the context of CALEA provides no support for CLEC claims that a call terminates at an ISP for purposes of the section 251(b)(5) reciprocal compensation obligation.

compensation was intended to fill a gap by addressing compensation for calls exchanged between competing local carriers in the same calling area; the legislative history makes clear that Congress intended to leave intact the compensation regime for long-distance calls, which was already well established.

- *Fourth*, § 251(g) further emphasizes that Congress did not intend reciprocal compensation to displace the existing access regime or displace the FCC's authority over that regime — to the contrary, given the care that Congress took to preserve the access regime, it would be bizarre to convert traffic for which LECs currently *receive* originating access charges into traffic for which LECs would be required to *pay* reciprocal compensation at state-set rates.

- *Fifth*, this conclusion is still further reinforced by § 251(i), which says that nothing in § 251 shall be construed to limit or otherwise affect the Commission's authority under § 201. As explained above, extending § 251(b)(5) to interstate access traffic would be flatly inconsistent with that rule of construction, because it would subject that traffic to reciprocal compensation at rates set *by the states*, not by the Commission, thereby limiting the Commission's prior authority under § 201 — the very result that Congress barred.

For these reasons, the Commission could not rely exclusively on section 251(b)(5) in implementing a comprehensive reform of intercarrier compensation, and could not rely on section 251(b)(5) as a source of authority for reforming the interstate or intrastate exchange access regime. Indeed, the Commission itself concluded in the *Local Competition Order*[7] that section 251(b)(5) cannot be read to preempt state authority to establish intrastate access charges, and that conclusion was never challenged. *See Local Competition Order* ¶¶ 732, 1033. Instead, as the Commission has repeatedly held — and, as the D.C. Circuit noted, "everyone agrees" — section 251(b)(5) "doesn't apply" to an "interexchange carrier phone call," whether interstate or intrastate. Transcript of Oral Argument, *WorldCom, Inc. v. FCC*, Nos. 01-1218 *et al.*, at 9-10 (D.C. Cir. Feb. 12, 2002) ("*WorldCom* Oral Arg. Tr."); *see also ISP Remand Order* ¶ 37 n.66 ("we again conclude that it is reasonable to interpret section 251(b)(5) to exclude traffic subject

[7] First Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499 (1996) ("*Local Competition Order*") (subsequent history omitted).

to parallel intrastate access regulations"). And the Commission has sources of authority other than section 251(b)(5) — such as its ability to regulate traffic that cannot be separated into interstate and intrastate components — that are likely to prove more suitable for comprehensive intercarrier compensation reform than section 251(b)(5). These alternative sources of authority, moreover, do not require adopting a result with respect to ISP-bound traffic that the Commission has already found leads to regulatory arbitrage and discourages local competition. Finally, to the extent that even these alternative sources of authority leave uncertainty about the Commission's authority, the proper response is to seek a legislative solution.

Nor will regulating ISP-bound traffic only under section 201 create any implementation problems, as some CLECs have claimed. Core Communications, Inc., for example, argues that, if ISP-bound traffic is subject only to section 201, the Commission will inevitably have to regulate Internet access as a common carrier service and ISPs as telecommunications carriers. *See* Letter from Michael B. Hazzard, Womble Carlyle Sandridge & Rice, PLLC, to Marlene H. Dortch, FCC, at 1 (Sept. 16, 2004); Letter from Michael B. Hazzard, Womble Carlyle Sandridge & Rice, PLLC, to Marlene H. Dortch, FCC, at 6-7 (Sept. 14, 2004). That claim is plainly wrong. When an information service rides on top of a jurisdictionally interstate telecommunications, the Commission can (but need not) regulate the telecommunications without also regulating either the information service or the information service provider — indeed, the Commission has been doing so for decades.

Level 3 similarly argues that the Commission must prescribe a method for implementing intercarrier compensation for ISP-bound calls. *See* Level 3 Sept. 10 Letter at 1. As an initial matter, because, as the Commission has concluded, carriers should be compensated for the costs of carrying ISP-bound traffic from their ISP customers, not from other carriers, *see ISP Remand*

Order ¶ 67, there is no need for such mechanisms. But if the Commission were to require payment of some rate, subject to a Commission-established rate cap, then carriers — both ILECs and CLECs — would be bound to implement that rule, such as through commercial agreements. Contrary to Level 3's claim, ILECs would not be able to "dictate" compensation rates in the face of such a Commission ruling. Level 3 Sept. 10 Letter at 1.

On the other hand, determining after all these years that ISP-bound traffic is subject to section 251(b)(5) *would* raise numerous implementation problems that the Commission would be required to resolve at this time. *See* White Paper at 53-56. For example, the Commission would need to address how its changed interpretation affects existing interconnection agreements. Carriers entering into interconnection agreements have consistently relied on the Commission's interpretation of section 251(b)(5) in effect at that time — whether the Commission's initial determination that section 251(b)(5) applies to local traffic only or its explicit determination in the *ISP Declaratory Ruling* that section 251(b)(5) does not apply to ISP-bound traffic. This is particularly true with respect to ILECs that relied on the *ISP Remand Order* when, to take advantage of the interim compensation regime for ISP-bound traffic, they were compelled to agree to receive materially lower payments from *all* CLECs on traffic that had always been subject to § 251(b)(5). *See ISP Remand Order* ¶ 89 & n.179. It would be inequitable — and impermissibly retroactive — to deprive ILECs of the benefit of this bargain by applying a new rule requiring higher payments for ISP-bound traffic only; and, moreover, it would be impossible to undo the effects of that bargain. *See Bell Atlantic Tel. Cos. v. FCC*, 79 F.3d 1195, 1207 (D.C. Cir. 1996); *see also Celtronix Telemetry, Inc. v. FCC*, 272 F.3d 585, 588-89 (D.C. Cir. 2001). Indeed, any attempt to undo that bargain would obligate the Commission to compel CLECs and CMRS providers that obtained the benefit of lower payments for traffic delivered to ILECs to make the ILECs whole, setting off new rounds of litigation and often involving carriers that are insolvent or no longer in business. If the Commission were to change its previous decisions and subject ISP-bound traffic to 251(b)(5) and 252(d)(2), it therefore must do so on an exclusively forward-looking basis, because the compensation requirement would constitute an entirely new rule that would displace the Commission's previous rules on the subject. *See Public Serv. Co. v. FERC*, 91 F.3d 1478, 1488 (D.C. Cir. 1996).

II. Preserving Commission Authority over Interstate Traffic Is Not an "Absurd Result"

In a related vein, AT&T *et al.* argue that limiting the application of section 251(b)(5) to traffic that originates and terminates in the same local calling area — as the Commission originally did — would "strip[]" the Commission of its "otherwise broad § 251(b)(5) rulemaking authority." AT&T Sept. 8 Letter[8] at 2. AT&T claims that this would lead to the "absurd result" that the "Commission has no § 251(b)(5) authority over" various types of calls, and that carriers would have difficulty implementing their reciprocal compensation obligations if these calls were excluded. *Id.* at 2; *see id.* at 3-4. These claims are false. First, the Commission has ample authority over each type of call AT&T addresses to the extent it is interstate or inseparably mixed, and the Commission already has addressed each of the examples cited by AT&T. Second, adopting AT&T's approach would have the truly absurd result of limiting the Commission's pre-existing authority over these calls to the extent they are interstate, contrary to the plain language of section 251(i). Third, AT&T's claims of implementation problems are overblown and contradicted by eight years of experience.

A. AT&T identifies a number of types of calls that are not subject to section 251(b)(5) because they do not originate and terminate in the same local calling area on the

[8] *See* Letter from David Lawson, Sidley, Austin, Brown & Wood, LLP, to Marlene H. Dortch, FCC (Sept. 8, 2004) ("AT&T Sept. 8 Letter").

networks of interconnecting LECs. But, as the Commission has already concluded, the Commission has authority to regulate these types of calls under section 201 to the extent that they are interstate and, in the case of CMRS traffic, under section 332. AT&T offers no reason why the Commission should construe section 251(b)(5) to limit the Commission's preexisting authority over these calls. Such an interpretation, as explained above, is in direct conflict with section 251(i), which states that section 251 is not to be construed to limit the Commission's preexisting authority. And the Commission would be giving up its existing authority for — at best — the prospect of exercising some, limited authority over non-local, intrastate traffic.

AT&T argues that certain types of calls — such as those forwarded to a voice-mail platform or a messaging service located in a distant exchange — do not originate and terminate in the same local calling area when the actual termination point of the communication is considered. *See* AT&T Sept. 8 Letter at 2. But AT&T ignores that the Commission has already addressed such calls and concluded that it has jurisdiction under section 201, because "there is a continuous path of communications across state lines between the caller and the voice mail service, just as there is when a traditional out-of-state long distance voice telephone call is forwarded by the local switch to another location in the state." *BellSouth Memory Call*[9] ¶ 9.

The same is true of each of the other types of circuit-switched calls that AT&T identifies. Thus, the Commission has already asserted jurisdiction under section 201 over calls to "leaky" PBXs, calls to credit card verification services, and to Feature Group A calls. *See, e.g.*, Memorandum Opinion and Order, *Access Billing Requirements for Joint Service Provision*, 4 FCC Rcd 7183, ¶¶ 21-26 (1989); *MTS/WATS Market Structure* ¶¶ 80-81. And, with respect to

[9] Memorandum Opinion and Order, *Petition for Emergency Relief and Declaratory Ruling Filed by BellSouth Corp.*, 7 FCC Rcd 1619 (1992) ("*BellSouth Memory Call*").

"roaming" wireless calls, the Commission has authority to regulate such calls not only under section 201, but also under section 332. *See*, *e.g.*, *Local Competition Order* ¶ 34.

There is nothing absurd about the conclusion that Congress did not intend for section 251(b)(5) to displace the Commission's jurisdiction over these calls to the extent that they are interstate. That is precisely what section 251(i) provides and it is what the Commission has repeatedly held. *See* 47 U.S.C. § 251(i); *Local Competition Order* ¶¶ 732, 1033; *ISP Remand Order* ¶ 37 n.66.

To the extent that AT&T is addressing the Commission's authority over interexchange, *intra*state traffic, there is also nothing absurd about interpreting section 251(b)(5) not to apply to existing state commission access regimes governing that traffic. Again, this is precisely how the Commission has interpreted section 251(b)(5) in the past and, as noted above, the D.C. Circuit has recognized that "everybody agrees" the Commission's interpretation is correct. *WorldCom* Oral Arg. Tr. at 9-10; *see Local Competition Order* ¶¶ 732, 1033; *ISP Remand Order* ¶ 37 n.66. Finally, AT&T is incorrect in claiming that inclusion of all of this traffic in section 251(b)(5) is necessary to implement comprehensive intercarrier compensation reform. As explained above, section 251(b)(5) is an insufficient statutory basis for such reform and the Commission has other sources of authority that provide more plausible bases for such a project. *See supra* p. 10.

B. By contrast, proceeding as AT&T suggests — by subjecting all traffic to the substantive and procedural standards that apply to section 251(b)(5) traffic — would *itself* lead to absurd results, by severely restricting the Commission's authority to regulate intercarrier compensation for traffic that had previously been within the Commission's jurisdiction.

Most glaringly, AT&T insists that the Commission's only regulatory option with respect to VoIP traffic is to subject such traffic to reciprocal compensation under section 251(b)(5) and to cede authority for implementation of such regulations to the several states. *See* AT&T Sept. 8 Letter at 3. That proposal is breathtaking in its wrongheadedness. If VoIP traffic were treated as subject to reciprocal compensation under section 251(b)(5), the Commission would lose substantial regulatory authority over such traffic, as the substantive and procedural standards of section 252 would apply to any intercarrier compensation arrangements for termination of traffic. It simply cannot be that Congress intended to impose on a new generation of services regulatory constructs designed for a circuit-switched world, as AT&T advocates.

Even in the case of traditional circuit-switched services, AT&T's proposal would reverse decades of precedent by subjecting traffic that was previously within the FCC's exclusive jurisdiction to regulation by the states. For example, AT&T argues that Feature Group A access, credit card verification calls, traffic to leaky PBXs, and wireless traffic — even when interstate — are subject to reciprocal compensation under section 251(b)(5). As a result, the Commission would not be free to adopt a new regulatory regime applicable to such traffic, but would be restricted, in each case, to replacing existing regulations with adoption of a pricing methodology to implement section 252(d)(2), leaving implementation to the several states.

C. Finally, AT&T argues that, unless these non-local calls are subject to reciprocal compensation, intractable problems will arise. That claim is not correct.

In fact, the vast majority of the litigation between interconnecting LECs over reciprocal compensation has been directly related to ISP-bound traffic.[10] As the Commission has recognized, ISP-bound traffic has generated such problems — not just endless litigation, but also anticompetitive arbitrage that has undermined the development of local competition — because

[10] For example, the issue of Virtual NXX traffic (as discussed below) would almost certainly never have taken on substantial importance but for the fact that CLECs have used Virtual NXX arrangements to serve ISPs, thereby worsening the arbitrage effect. *See* White Paper at 57, 59; *infra* pp. 20-25.

of the unique characteristics of such traffic (and ISPs as customers). ISPs generate an enormous volume of incoming minutes, because the hold times for ISP-bound calls are much longer than average. At the same time, ISPs generate no outgoing minutes at all. As a result, CLECs have cultivated ISPs to harvest a reciprocal compensation windfall.[11]

The same cannot be said of the other types of traditional circuit-switched traffic to which AT&T refers. For example, while traffic that is forwarded to a voice-mail platform is normally not, in fact, subject to reciprocal compensation, there is no reason to believe that voice-mail subscribers are particularly likely either to generate large volumes of incoming minutes or to avoid making outbound calls, some of which will be sent to the receiving caller's voice-mail platform. Absent a systematic effort to manipulate the system, carriers might easily agree to treat such traffic as a wash rather than to spend significant sums to address what is likely to be insignificant differences. In other cases — as with roaming wireless traffic — the volume of traffic has been sufficient to justify the development of factors on a carrier-by-carrier basis to address the issue.[12]

---

[11] There has also been litigation related to the application of reciprocal compensation to paging providers, but that additional example further reinforces the point. Paging carriers generate no in-coming minutes, and they have been able to manipulate number assignment to foist the cost of transporting traffic off on LECs. Nonetheless, because calls to paging carriers do not have the extremely long hold times associated with ISP-bound traffic, the opportunities for anticompetitive arbitrage have not reached the same magnitude as with ISP-bound traffic.

[12] Oddly, Pac West has claimed that the imposition of reciprocal compensation on traffic exchanged between LECs and CMRS providers *supports* the claim that section 251(b)(5) is not limited to traffic originated and terminated within the same local calling area. *See* Letter from Richard M. Rindler, Swidler Berlin Shereff Friedman, LLP, to Marlene H. Dortch, FCC, at 7-8 (Sept. 8, 2004). In fact, the Commission determined in the *Local Competition Order* that, while reciprocal compensation would apply to traffic exchanged between LECs and CMRS providers, it would apply only to local traffic — defined as traffic that originates and terminates within the same MTA. The fact that the Commission, and not state commissions, defined the scope of the local calling area for reciprocal compensation purposes is not surprising, because the scope of Commission authority over CMRS traffic is *not* limited to interstate traffic. *See* 47 U.S.C. § 332.

With respect to VoIP, which is also part of AT&T's parade of horribles, the Commission has not yet addressed the proper treatment of calls between VoIP and circuit-switched customers for purposes of intercarrier compensation. One thing that is clear, however, is that, to the extent that such VoIP calls are interstate — and they are — this Commission has jurisdiction over that service under section 201. *See, e.g., Pulver.com*[13] ¶¶ 20, 22. If the Commission were to determine that such calls are subject to section 251(b)(5), it would shift jurisdiction over such calls to state commissions in the first instance, as explained above. AT&T's list of hypothetical problems that might arise provides no reason for the Commission to undermine its efforts to assert exclusive federal authority over the Internet and Internet-Protocol-based traffic and services, by assigning a key component of the Commission's overall policy to the states.

III. The Commission Should Not Eliminate the Growth Caps, Rate Caps, and New Market Restrictions Established in the *ISP Remand Order*

Xspedius takes issue with the growth caps, rate caps, and new market restrictions that the Commission established in the *ISP Remand Order*. Xspedius Sept. 16 Letter,[14] Attach. at 6-7; *see also* ALTS Sept. 22 Letter at 3 & n.11. As the Commission explained, it put these rules in place to "limit, if not end, the opportunity" for *CLECs* to engage in "regulatory arbitrage." *ISP Remand Order* ¶ 77; *see id.* ¶¶ 21, 29. Extensive record evidence demonstrated that CLECs "targeted ISPs as customers merely to take advantage of these intercarrier payments" — approximately two billion dollars annually — and were affirmatively discouraged from providing local voice service. *Id.* ¶ 2; *see id.* ¶¶ 5, 21, 70-71, 87 n.171. Moreover, the Commission recognized that reciprocal compensation payments created market distortions, such

[13] Memorandum Opinion and Order, *Petition for Declaratory Ruling That pulver.com's Free World Dialup Is Neither Telecommunications Nor a Telecommunications Service*, 19 FCC Rcd 3307 (2004) ("*Pulver.com*").

[14] *See* Letter from Brett Heather Freedson, Kelley Drye & Warren LLP, to Marlene H. Dortch, FCC (Sept. 16, 2004) ("Xspedius Sept. 16 Letter").

that neither ISPs nor their dial-up customers were receiving accurate price signals. *See id.* ¶¶ 68, 71, 74, 77. For both reasons, the Commission concluded that CLECs, like incumbents, can and should "recover the costs of delivering traffic to ISP customers directly from those customers." *Id.* ¶ 67; *see id.* ¶¶ 87-88.

Xspedius, however, claims that rules put in place to "provide a transition toward bill and keep" and "a standstill on any expansion of the old compensation regime into new markets," *id.* ¶¶ 80-81, actually create arbitrage opportunities for *ILECs.* *See* Xspedius Sept. 16 Letter, Attach. at 6-7.[15] In fact, even with the growth caps, rate caps, and new market restrictions, many CLECs still focus exclusively on serving ISPs to reap the payments available under the Commission's interim compensation regime — for example, Verizon still sends CLECs, on average, nearly 14 times as much traffic as it receives. In the first eight months of 2004, Verizon has sent more than 123.5 billion minutes of local and ISP-bound traffic while receiving only 9 billion minutes from CLECs. This means, using the Commission's overly conservative 3:1 ratio for identifying ISP-bound traffic, that Verizon's customers *alone* will generate more than 140 billion minutes of dial-up ISP-bound traffic.[16] Thus, even with the growth cap and new market

[15] Xspedius also contends that these rules discriminate against certain carriers. But contrary to these claims, the Commission sensibly drew a distinction between companies that had already entered markets and signed contracts with customers based on prior reciprocal-compensation rules and those that sought to do so for the first time. *See ISP Remand Order* ¶ 77. And because all CLECs that are entitled to some compensation for ISP-bound traffic under the interim compensation regime are capped at the compensation they are receiving for the minutes generated by their existing ISP customers (including the growth in usage expected by those customers), *see id.* ¶ 86, the regime provides none of these CLECs with advantages over any other CLECs in winning *new* customers. These CLECs, however, are in a far better position than the incumbent LECs, which have *never* been able to use reciprocal-compensation windfalls to offer ISPs below-cost service, have had to recover their costs from their own ISP customers, and (to make matters worse) have been forced to pay billions to subsidize their rivals. *See id.* ¶ 83.

[16] Applying the 3:1 presumption, 96.5 billion minutes of use are presumed to be ISP-bound (123.5 billion outbound mou - (9 billion inbound mou x 3) = 96.5 billion mou).

restrictions — which prevent CLECs from looking to Verizon for compensation for all of this traffic — and with the rate cap limiting compensation from Verizon to $0.0007/mou, CLECs are still serving ISPs that generate a tremendous amount of traffic.[17] If any of these restrictions were lifted — let alone all of them — there can be no question that CLECs would seek to generate even more dial-up ISP-bound traffic.

While CLECs thus continue actively to pursue the regulatory arbitrage opportunities presented by serving ISPs, incumbents do not encourage their customers to subscribe to the dial-up services of ISPs that are customers of CLECs to take advantage of a supposed "cost-savings windfall." Xspedius Sept. 16 Letter, Attach. at 7. On the contrary, incumbents are encouraging their customers to access the Internet through DSL and are in heated competition with the dominant cable providers;[18] any customer that uses dial-up service continues to impose costs on incumbents. Thus, there can be no serious argument that the Commission's growth caps, rate caps, and new market restrictions create arbitrage opportunities for ILECs.

Finally, the preservation of intercarrier compensation for dial-up ISP traffic — let alone the expansion of such compensation through the elimination of the growth caps, rate caps, and new market restrictions — discourages wider adoption of broadband service by providing an

---

Extrapolating from the first eight months of 2004 to the entire year yields a total of 144.8 billion mou (96.5 billion x 12 / 8 = 144.8 billion mou).

[17] Even at the lower rates for traffic subject to the interim compensation regime — and CLECs have fought at every turn to prevent the interpretation or amendment of existing agreements, or the adoption of new agreements, to effectuate that interim regime — the market distortions are, at best, mitigated, and CLECs still have the incentive to focus on inbound-only customers, instead of competing for local voice customers. Indeed, the Commission itself recognized that these market distortions "*cannot* be cured by regulators or carriers simply attempting to 'get the rate right.'" *ISP Remand Order* ¶ 76 (emphasis added).

[18] *See*, *e.g.*, Ex Parte Letter from Michael K. Kellogg, Kellogg, Huber Hansen, Todd & Evans, PLLC, to Michael K. Powell, Chairman, FCC, CC Docket Nos. 01-338 *et al.* (FCC filed Aug. 18, 2004).

uneconomic cost advantage for the ISPs that provide dial-up service and the CLECs that serve them. The market for dial-up ISP service thus is still characterized by inaccurate price signals and end-user customers are given a price incentive to keep data traffic off of broadband networks, to which reciprocal compensation does not apply. Second, investment in broadband networks is discouraged. In particular, CLECs are discouraged from investing in broadband networks to serve end-user customers, because they would lose the intercarrier compensation payments that accompany dial-up ISP-bound traffic.

In short, eliminating the growth caps, rate caps, and new market restrictions would lead to the very regulatory arbitrage the Commission has sought to eliminate and would undermine the Commission's broadband policies.

IV. The Commission Should Limit Any Intercarrier Compensation Rules It Establishes to Calls by an End User to an ISP Located in the Same Local Calling Area as the End User

In the *ISP Remand Order*, the Commission did not explicitly address whether its interim compensation regime was limited to calls to an ISP in the same local calling area as the calling party — that is, to calls that would have been subject to reciprocal compensation if made to a voice customer. As a result, CLECs have argued, and some state commissions have found, that the interim regime applies to *all* calls to ISPs, including long-distance and 1-800 calls. *See, e.g.*, ALTS Sept. 22 Letter at 3. The D.C. Circuit, however, had no difficulty recognizing that the Commission had held that "calls made to [ISPs] *located within the caller's local calling area*" are not subject to section 251(b)(5), but that, instead, compensation for such calls is subject to the "interim provisions devised by the Commission." *WorldCom*, 288 F.3d at 430 (emphasis added).

The Commission should confirm that the D.C. Circuit was correct and should ensure that it holds explicitly that interexchange calls to ISPs are not subject to any compensation regime it adopts specifically for ISP-bound traffic. Indeed, the D.C. Circuit's understanding of the *ISP Remand Order* is not surprising, because the question before the Commission has *always* been whether calls to an ISP in the same local calling area as the calling party are to be treated the same as calls to a local business. Thus, in the *ISP Declaratory Ruling*,[19] the Commission rejected CLECs' arguments that a call to an ISP "terminate[s] at the ISP's *local* server" and "ends at the ISP's *local* premises." *ISP Declaratory Ruling* ¶¶ 12-15 (emphases added). That is because CLECs were arguing that their ISP customers were, in fact, physically located in the same local calling areas as the customers placing calls to them — with some CLECs going so far as to draw pictures depicting the ISP having a physical presence in the same local calling area as the ILEC customer placing the call. *See* Comments of Teleport Communications Group, CCB/CPD 97-30, Attach. (July 17, 1997). In fact, as Verizon and BellSouth would later come to discover, this was rarely the case even in 1996 and 1997.

Indeed, many calls to ISPs for the purpose of accessing the Internet are interexchange calls before they ever reach the ISP. But because CLECs have assigned their ISP customers multiple telephone numbers in calling areas throughout one or more LATAs, incumbents' customers always have a choice of "local" numbers to use to place these interexchange calls. For this reason, even though incumbents bear the cost of the interexchange transport for such calls, they cannot charge their retail customers the toll charges that would normally apply. The CLECs, in contrast, incur very little transport cost — as ALTS notes, an ISP "typically collocates its server at the switch site of its serving [C]LEC," ALTS Sept. 22 Letter at 4 n.15 — yet, in addition to getting free interexchange transport, demand to get paid by the ILEC *on top of* the

[19] Declaratory Ruling in CC Docket No. 96-98 and Notice of Proposed Rulemaking in CC Docket No. 99-68, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 14 FCC Rcd 3689 (1999) ("*ISP Declaratory Ruling*"), *vacated*, *Bell Atlantic Tel. Cos. v. FCC*, 206 F.3d 1 (D.C. Cir. 2000).

amounts they charge their ISP customers. The CLECs, thus, seek to invert the standard compensation rules — under which the carrier of the party *receiving* a toll-free, interexchange call (which is paid by its customer) compensates the carrier of the party placing the call (which is not) — and force ILECs to subsidize their provision of a service functionally equivalent to 1-800 service.

For example, one common arrangement that CLECs use to provide service to their ISP customers is known as Virtual FX or Virtual NXX. Indeed, for some CLECs, 100% of the traffic they deliver to ISPs is Virtual NXX traffic.[20] Under this arrangement, a CLEC with a switch in Philadelphia would assign its ISP customers — normally collocated at its switch or located only a short distance away — telephone numbers associated with calling areas throughout the Philadelphia LATA including, for example, the Allentown local calling area. Normally, a call from a customer in Allentown to a customer in Philadelphia would be a toll call, and the incumbent, as the originating carrier, could either collect toll charges from its customer or access charges from the IXC. But, because the CLEC has assigned its customer a "local" Allentown number, the incumbent's systems would be tricked into thinking that the call was delivered in Allentown. The incumbent would not receive the compensation normally due on an interexchange call, even though the incumbent would perform the interexchange transport necessary to deliver the call from Allentown to the CLEC's chosen point of interconnection near its switch in Philadelphia. Even though these are interexchange calls and the incumbent alone

[20] *See* Memorandum Opinion and Order, *Starpower Communications, LLC v. Verizon South Inc.*, 18 FCC Rcd 23625, ¶ 17 n.64 (2003).

bears the interexchange transport costs,[21] the CLECs claim that the intercarrier compensation regime established in the *ISP Remand Order* entitles them to compensation for such a call.[22]

Other CLECs provide their ISP customers with an interLATA foreign exchange service, picking up traffic in one LATA and delivering that traffic to ISPs in another LATA (or another state). Global NAPs, for example, has assigned telephone numbers associated with calling areas throughout *New England* to ISPs located at or near its switch in Quincy, Massachusetts. Level 3 has similarly assigned numbers associated with calling areas in the Pittsburgh LATA to ISPs located in Baltimore. *See, e.g.*, Opinion and Order, *Level 3 Communications, LLC v. Marianna & Scenery Hill Tel. Co.*, Docket No. C-20028114 (Pa. PUC Jan. 7, 2003). Level 3 receives these calls in Pittsburgh and then transports them across LATA and state boundaries to the ISP in Maryland. Again, CLECs claim that the interim compensation regime applies to these calls as well, even though the Commission has squarely ruled that interLATA FX voice calls are subject to access charges, just like any other interLATA calls. Indeed, by CLECs' logic, 1+ and 1-800 dialed calls to ISPs likewise are covered by that regime, all of which would have the effect of turning the Commission's and state commissions' established rules on their head — instead of getting compensated for originating these interexchange calls, incumbents would be forced to pay compensation.

But there was no reason for the Commission to subject *any* of these interexchange calls to its interim compensation regime in the *ISP Remand Order* and there is no reason for the

---

[21] The ILEC's customer does not bear those costs because of the CLEC's number-assignment practice. Neither the CLEC nor its customer bears those costs because the ILEC performs the transport.

[22] While ALTS implies that Virtual NXX primarily benefits customers in "rural" areas and other locations "where prohibitively expensive toll calls would be the only" option, ALTS Sept. 22 Letter at 3-4, in fact, the primary beneficiaries are CLECs and ISPs. Indeed, the CLECs that specialize in serving ISPs use Virtual NXX *everywhere,* even in densely populated areas.

Commission to do so now, much less to preempt state commission decisions that have correctly found that incumbents have no obligation to compensate CLECs for Virtual NXX and other interexchange calls to ISPs. *See* Level 3 Sept. 10 Letter at 2; ALTS Sept. 22 Letter at 4. Indeed, while the vast majority of state commissions had held that calls to ISPs in the same local calling area *are* subject to reciprocal compensation — creating the very arbitrage opportunities that the Commission sought to address by adopting the interim compensation regime — a comparably large majority (23-7) has held that Virtual NXX calls are *not* subject to reciprocal compensation, or, in a few cases, have refused to permit CLECs to provide Virtual NXX arrangements altogether.[23] Because these state commissions have not permitted CLECs to force ILECs to bear the costs of the toll-free service that these CLECs provide to their ISP customers, those decisions did not create the opportunity for regulatory arbitrage.[24] Finally, applying different intercarrier compensation rules to *inter*- and *intra*-exchange calls to ISPs is entirely consistent with — indeed, compelled by — the ESP exemption. As noted above, the ESP exemption enables *ISPs* and other *ESPs* to avoid paying the access charges that otherwise would apply to the interstate

[23] Contrary to Level 3's claims (Sept. 10 Letter at 2), the few commissions that have denied CLECs serving ISPs access to local numbers have done so *not* because the CLECs were serving ISPs, but because the CLECs were interested in using those numbers exclusively to provide Virtual NXX service. There is no reason for the Commission to preempt state commission decisions not to permit the use of numbering resources for Virtual NXX service. When a CLEC requests numbers associated with an area where that CLEC has *no facilities* and *no customers* — as is normally the case for CLECs that provide Virtual NXX service to ISPs — that CLEC can hardly be said to be "provid[ing] service in the area for which the numbering resources are being requested." 47 C.F.R. § 52.15(g)(2).

[24] Contrary to ALTS's claim (Sept. 22 Letter at 3 n.14), if the Commission were to affirm that Virtual NXX calls are not subject to reciprocal compensation, ISPs would not be required "to establish a point of presence in every single central office in the country." Instead, ISPs could maintain their centralized arrangements but would (along with CLECs) simply have to bear the cost of the toll-free service arrangements that the use of Virtual NXX enables, just as an ISP must do when it subscribes to 1-800 service.

access services that they use. *See ISP Remand Order* ¶ 55.[25] The ESP exemption, however, does not apply to *CLECs or IXCs* and does not alter the traditional distinction between inter- and intra-exchange traffic.

[25] Indeed, it is because of the ESP exemption that, as Level 3 contends, ISP-bound traffic is exchanged over "251(c)(2)" — *i.e.*, local — "interconnection trunks." Level 3 Sept. 10 Letter at 2.

Respectfully submitted,

MARK L. EVANS
AARON M. PANNER
SCOTT H. ANGSTREICH
KELLOGG, HUBER, HANSEN,
TODD & EVANS, P.L.L.C.
Sumner Square
1615 M Street, N.W., Suite 400
Washington, DC 20036
(202) 326-7900

WILLIAM P. BARR
MICHAEL E. GLOVER
EDWARD SHAKIN
VERIZON
1515 North Courthouse Road
Suite 500
Arlington, VA 22201-2909
(703) 351-3099

BENNETT L. ROSS
BELLSOUTH CORPORATION
Suite 900
1133 21st Street, N.W.
Washington, DC 20036-3351

September 24, 2004